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Population Ageing and Housing: Policy Implications

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Introduction

Population ageing, a demographic transition that will accelerate in NSW over the next few decades, is creating economic opportunities as well as significant challenges for the NSW economy and the state government. On the one hand, a growing number of seniors represent a powerful economic force in terms of their consumption spending and their housing assets. On the other, a rapidly growing proportion of the elderly in the population will put upward pressure on publicly funded age-related expenditures, particularly on health care spending. Furthermore, reduced population growth and a declining proportion of the working-age population is expected to lower employment growth and demand for housing, negatively affecting the government's main sources of tax revenues - payroll tax and property taxes. As a result, the gap between government expenditures (that are expected to grow further due to non-age related factors such

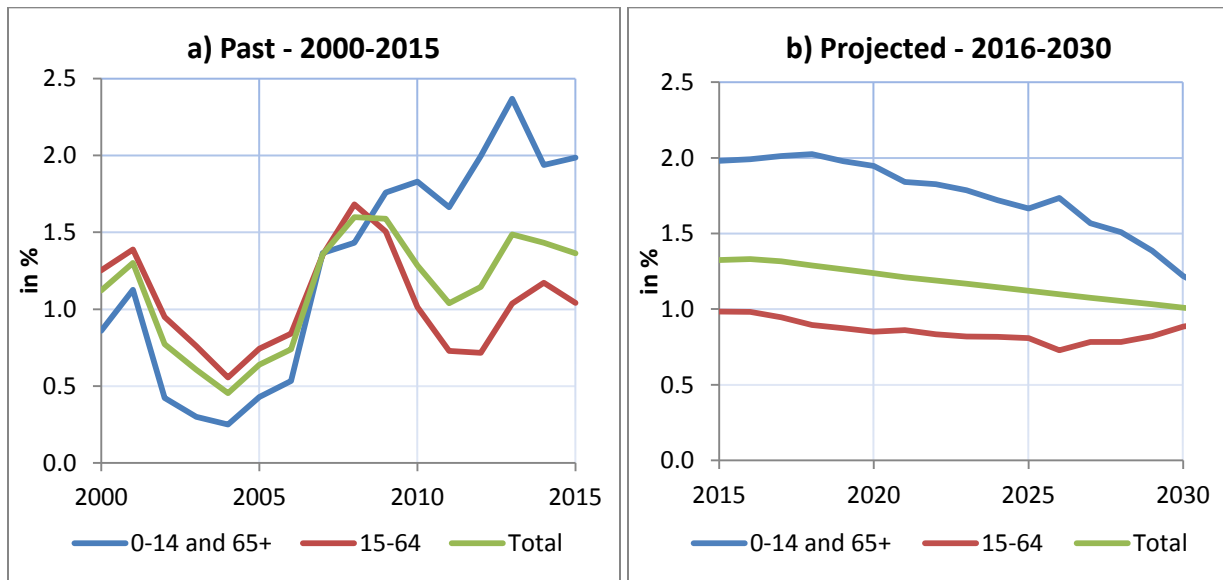
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as medical advances) and taxation revenues will widen in the future due to an ageing of the NSW population.

Figure 1 shows the (past and projected) total population growth rate and its decomposition into the growth rates of the working age population aged 15-64 and of populations aged 0-14 and 65+. ³ As shown, not only is total population growth projected to decline but also the projected growth of the working-age population is significantly smaller than the growth of those aged 0-14 and 65+ who are the main recipients of the government support. The figure indicates that since 2008, the growth of the dependent population aged 0-14 and 65+ has been higher than that of the working age population, with the gap currently (in 2015) amounting to about one percentage point. This gap is projected to continue, although it will somewhat narrow mainly due to migration inflows. This highlights an important challenge for the state government, with expenditures addressed to populations aged 0-14 and 65+ growing at a faster rate than tax revenues collected mainly from the working age population.

Figure 1: Population growth rates in NSW



Source: ABS (2013), Population projections, Australia, 2012 to 2101; ABS (2014), Australian historical population statistics; ABS (2015), Australian demographic statistics.

In this report, we discuss some policies to mitigate the fiscal burden due to population ageing and boosting economic growth in NSW. We focus on the role of housing and

³ Past population growth rates are based on Australian Bureau of Statistics [ABS] (2014, 2015) and future growth rates are taken from the projections by ABS (2013).

immigration. We first discuss implications of population ageing for macroeconomic aggregates and housing. We then consider the role of migration for the labour market and the government budget. A separate section is devoted to older people, their housing assets and their importance to a healthy economy. Finally, we discuss the link between housing and health, and suggest policies to mitigate the projected expenditures on health care.

Economic and fiscal effects of population ageing

NSW, like Australia and other developed countries, has an ageing population, attributable to falling mortality and, especially, lower fertility rates. Projected mortality improvements in the next few decades will accelerate the ageing of the state population. Overall population is expected to increase, due mainly to net overseas migration inflows. Such fundamental demographic changes will impact the NSW economy and place increasing demands on the state government that will see spending on old-age related benefits outstripping revenues from payroll and property taxes.

A large body of research focuses on the effects of population ageing in both developed and developing countries (for the relevant literature, see Kudrna and Woodland, 2011). In Australia, the economic and fiscal challenges caused by demographic shift are quantified in the reports produced by the Australian Government (2010, 2015), Productivity Commission (2005, 2013) and by the NSW Government (2011) for NSW. Using micro-simulation models, these government reports show negative macroeconomic effects in terms of reduced labour supply and output (relative to the economy with no population ageing) and a significant long-term fiscal gap.

Kudrna *et al.* (2015) also study the effects of demographic shift in Australia but apply an alternative analytical tool comprising a life-cycle, general equilibrium model that incorporates behavioural responses by agents to population ageing. Their findings indicate that accounting for behaviour household responses (i.e., higher lifecycle labour supply and savings due to increased longevity) helps to some extent mitigate the negative economic and fiscal effects of population ageing found in the above-mentioned government reports. In addition, Ludwig *et al.* (2012), who examine projected demographic changes in the US, demonstrate that accounting for endogenous human capital accumulation further mitigates the negative impact of demographic change on

macroeconomic aggregates and individual welfare. They show a strong incentive to invest in human capital from the combined effects of increasing life expectancy and changes in relative prices (i.e., increased wages and asset prices due to population ageing).

The findings of these two studies have important policy implications: they indicate that well-informed households can substantially mitigate the impact of demographic change (on the NSW economy, total wage bill and payroll tax revenues), particularly if pension and health care systems are reformed such that contribution and tax rates remain constant.

Population ageing and housing

Population ageing is also expected to impact housing markets and house prices. According to the ‘asset meltdown’ hypothesis (Poterba 2001), asset prices including house prices will decline as retired baby boomers sell off their assets to fund their retirement consumption. In addition, a declining proportion of the working-age population is expected to lower demand for housing, putting further pressure on house prices and the state tax revenues from property taxes. Nevertheless, the extensive literature on this topic surveyed by Poterba (2004) points only to weak evidence of a positive correlation between the relative size of the working age population and asset prices.

Econometric studies of the determinants of house prices in Australia do not provide strong evidence of demographic effects on house prices either (Abelson *et al.* 2005; Otto 2007). As pointed out by Guest and Swift (2010), this may be due to the particular model specifications with aggregate population growth used as an explanatory variable accounting for demographic change. Instead, Guest and Swift use the population share of 35 to 59 year olds as one of the explanatory variables of house prices in their econometric model. They point to evidence provided by Reserve Bank of Australia that suggests people aged 35 to 59 years mainly drive house prices in Australia. They find that the ageing of Australia’s population with the falling population share of the 35-59 age group may cause average house prices to be between 3% to 27% lower than they otherwise would be over the period of 2008-2050.

While population ageing is expected to put downward pressure on house prices and housing demand, financial innovations that provide households with access to their housing equity may

reduce these effects. Financial products such as equity redraw facilities and reverse mortgages reduce selling pressure on house prices because households can withdraw equity to fund their consumption without a need to trade down in old age. The use of equity to purchase additional (investment) property also implies higher demand for housing, thus putting buying pressure on house prices. Further work is needed by governments to generate an appropriate regulatory environment in which such products can find their place. Financial education to improve financial literacy may also be necessary to ensure that the trend toward more flexible use of housing equity continues.

Economic effects of migration

Immigration has recently become the major contributor to population growth in Australia. In NSW, the natural component of population growth (i.e., changes in the number of births and deaths) has been declining, but net overseas immigration rate has increased from less than 0.4% in 1975 to over 0.8% in 2015 (ABS 2015). Although immigration is very volatile and there is a great deal of uncertainty about future immigration, the declining natural increase suggests an increasingly important demographic impact of net overseas migration in the future. Net overseas immigration not only increases the size of the total population but it also changes the age distribution of the population. In NSW, immigrants are concentrated in younger and economically active age groups, which is particularly important as they contribute to reduce dependency ratios.

Higher immigration of especially young and skilled workers is often seen as a way to mitigate the negative effects of population ageing on the government budget because they will work, accumulate capital and pay taxes to the government. There is a large body of research on the economic and fiscal impacts of migration, indicating that these effects depend mainly on the age of migrants and the size of the economy. Guest and McDonald (2000) show a significantly positive effect of net immigration on a small open economy like Australia, whereas the economic and fiscal effects of increased immigration are far less significant for a large economy, as shown by Fehr *et al.* (2004) for the United States.

The Organisation for Economic Co-operation and Development (OECD) has recently examined how immigrants impact the economy and whether migration is good for the economy

(OECD 2014). Their findings indicate that migrants contribute: (i) significantly to the labour market (e.g., 70% of increase in the workforce in Europe over the past 10 years due to migration); (ii) more in taxes and social contributions than they receive in benefits; and (iii) to human capital development, innovations and technological progress to spur economic growth. The report also emphasizes that labour migrants have a much more favourable impact on the economy than other migrant groups, especially on the labour market and the government budget.

In Australia, managed labour migration represents a significant component of total immigration. Cully (2011) reports that labour or skilled migrants (including accompanied family) accounted for over 60% of the total permanent immigration in 2010-11. He also shows the importance of duration of residence after migrants arrived in Australia. Using the “Migrants’ Fiscal Impact” model, the positive net impact of permanent migrants on the government budget is shown to almost double over a 20 year period of settlement in Australia (increasing from \$3,910 per migrant in the first year of settlement to \$7,410 per migrant in 20th year of settlement). OECD (2013) estimates the net impact of immigration on the Australian government budget to be 0.82% of GDP. The report also shows an additional increase of 0.5% of GDP if immigrants had the same employment rate as the native-born. This expected gain would mainly come from immigrant women and highly-educated immigrants, who both have significantly lower employment rates than their native-born counterparts. Given that the age structure of NSW immigrants is very similar to that of Australia’s immigrants and that around 36% of all Australian immigrants are settled in NSW, the effect of overseas immigration on the NSW budget (as a percentage of GSP) is likely to be similar to that reported by OECD (2013) for Australia.

Increased immigration concentrated in the prime working ages of 25 to 45 years (contributing to population growth and in particular to growth of the working age population) will be supportive for housing demand and limit downward pressure on house prices as the population ages. This is especially true because immigrant populations in NSW largely settle in large metropolises (especially Sydney), increasing house prices for the relevant urban area.

It is therefore essential to design education, employment and housing policies to attract immigrants, and to maximise the benefits of migration, especially as rapid population ageing increases demand for migrants to make up shortfalls in the workforce.

Older people and housing

The policy paper by the Housing and Ageing Alliance [HAA] (2013) on demographic change and housing highlights the contributions of a growing number of older people to the UK economy in relation to their consumption of goods and services and substantial housing equity. The paper points to a potentially growing market for adaptations, maintenance and improvements to older people's housing. The paper also discusses use of equity in older people's housing as a solution to a range of social and economic issues: meeting the cost of later life care, topping up public pensions and supporting younger generations.

The Australian population of people aged 65 years and over will also increase significantly over the next few decades, both in size and as a proportion of the total population. According to the ABS (2013) population projections for NSW, between 2015 and 2050, it is expected that population ageing will increase the number of people aged 65 years and over from 1.2 to 2.35 million, with the population share of the elderly increasing to 23% by 2050. Also note that the homeownership rates among older Australians are one of the highest in the developed world. In NSW, more than 80% of people aged 65 years and over are homeowners, mostly owning their homes with no mortgage. Coupled with significant increases in house prices in NSW (the median NSW dwelling price increased by 262% between 1991 and 2013)⁴ this indicates that like the UK elderly, older Australians hold significant housing equity.

HAA (2013) discusses the economic and social benefits of age friendly housing, housing related services and accessible environments. The report proposes a number of recommendations to maximise the impact of older people's housing on the UK economy. These recommendations include: (i) development of new homes to be designed to lifetime home standards and to include a wide variety of housing for older people (with aims of creating jobs in the construction industry and of releasing housing wealth of older people wanting to downsize to increase their spending

⁴ See Haylen (2014).

power); (ii) designing and building homes for older people in appropriate locations with infrastructure planning and integrated support services in place (to enable older people to remain economically and socially active; (iii) removing barriers to innovate and flexible forms of housing in later life (to allow people to live independent and self-sufficient lives for longer); and (iv) providing older people with reliable local services and products that are age-friendly (to increase their confidence to spend in ways that support their independence and improve their quality of life).

Given the high homeownership and housing equity of older people residing in NSW, the same policy recommendations as those listed above should apply to NSW and the state government.

Housing and health

Health expenditure is one of the major outlays of the state government. As older people are the main users of both hospital and primary care, an ageing of the state's population with a growing number of older people is expected to substantially increase the health bill. The NSW Government (2011) shows that the projected increases in the health expenditures are one of the key drivers of the fiscal gap for the state budget due to population ageing.

Housing quality and suitability is one of the major determinants of health and well-being of older people, as pointed out by HAA (2014). According to the World Health Organization, there is a causal link between housing and the major long-term health conditions (e.g., heart disease and stroke) and the risk of falls is significantly affected by housing characteristics.⁵

HAA (2014) argues that suitable housing for older people can reduce the costs of health care by reducing GP visits, enable timely hospital discharge, extend independence for patients with dementia and provide end-of-life care at home. Adaptation and improving existing homes occupied by seniors, development of specialist housing and provision of housing related support can contribute to efficient government savings in terms of reduced growth in health care expenditures.

⁵ See World Health Organization [WHO] (2012).

Conclusion

The ageing of the state's population generates challenges and opportunities for government, business and families. With no policy or behavioural adjustment, demographic change would have very serious impacts on fiscal balance, on economic activity, and on individual welfare.

Adjustments have a range of impacts. First are adjustments and policies which influence the impact of an ageing demographic. Individuals adjust by investing more in human capital, working longer, and modifying their consumption and saving habits. These adjustments combine to somewhat offset the effects of an ageing demographic. Policy on migration, especially managed migration geared toward the labour market, such as exists in Australia, have a major impact on effective societal ageing.

Second, there are adjustments that can be made to infrastructure, including especially housing. Housing is simultaneously an important commodity whose affordability and access are a major influence on migrant flows. Policy needs to respond so that commutable housing is available for young workers, through zoning, transport infrastructure, and other adjustments. Housing in which older people live needs to be modified to allow occupancy until later in the life course, and its embodied wealth needs to be unlocked through measured development and use of equity release products such as reverse mortgages. This will have potential impact on consumption spending, on well-being through facilitating "ageing-in-place", and possibly through reducing intergenerational inequity by providing mechanisms through which housing can help self-provide through a person's declining years, rather than provide unintended bequests to the next generation, with uneven spread and value distribution.

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